Exit strategy

The best outcomes for business owners come through careful planning and preparation

The process begins well in advance of putting up a “for sale” sign. In this guide to selling a business, Grant Thornton outlines the key factors for business owners to consider.

Timing and the market

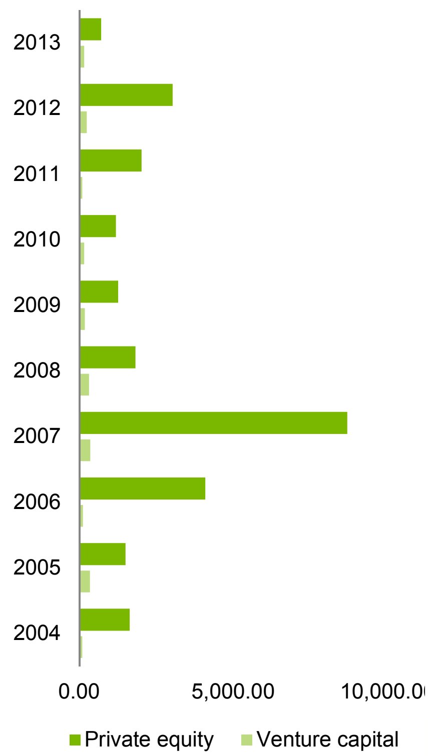
Over the last decade, capital markets around the world saw the pendulum swing from one extreme to the other. Initially awash with funds primarily accumulated through a decade of economic growth and compulsory superannuation savings. Then, the Global Financial Crisis and ensuing turbulent economic events worldwide created an environment of uncertainty.

Low interest rates and low yielding traditional investments had driven fund managers to seek alternative investment strategies.

Whether through expansion strategies of larger corporates, consolidation strategies of private equity managers or purely direct investment, this money is finding a home in middle market privately owned businesses.

Now more than ever it is important for business owners to consider their succession planning options and the future of their equity.

Figure 1: Investments by fiscal year



Source: Australian Private Equity & Venture Capital Association Limited 2013 Yearbook - December

“Even during the global financial downturn of 2007-08, growth funds remained active, focusing on supporting their investee companies through the tough economic climate. In recent years, however, the number of investments has declined as a tight fundraising market has seen fewer new funds being raised to invest in growing businesses: a trend also observed in the broader private equity market.”

The Australian Private Equity and Venture Capital Association Limited (AVCAL)

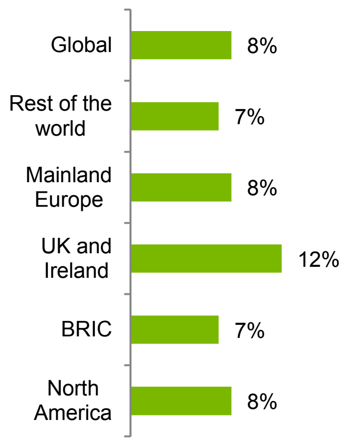
Exit perceptions

Business owners are often reticent about disclosing their long term ownership plans.

The Grant Thornton International Business Report (IBR) 2013 year's results illustrate globally only 8% of businesses state that they foresee an exit over the next three years, the lowest level since 2008. This global decrease indicates a reaction to a turbulent 2012 and maybe a reflection of business owner's views that they may not be able to attract the level of interest or price acceptable to them. The 2013 IBR also found selling to a competitor is the most likely exit route for businesses in the current climate.

To find out more about IBR and to obtain copies of reports and summaries visit:
www.internationalbusinessreport.com

Figure 2: Businesses most likely to sell in the next three years



Base = percentage of businesses foreseeing a change of ownership over the next three years
Source: Grant Thornton International Business Report 2013

What is the business worth?

This is a question close to the hearts of every business owner. Understanding the components of value can steer the owner toward a "value improvement strategy" that results in a substantially better exit outcome.

Perhaps the single biggest determinant of the value of a business is its current and recent profit history. It represents the reward to the business owner, and of course, the future business owner.

The second major determinant of the value of a business is "future risk". It is an assessment of the probability that the profit of the business will be maintained or grows. Factors to be considered in assessing this risk include:

- the dependency of the business on the business owner
- sustainability of competitive advantage
- intellectual property
- growth and profit trends
- business disciplines and practices
- culture and professionalism
- the market in which the business operates

Whilst "profit" and "risk" can see opposing accountants argue about theoretical value indefinitely, the ultimate determinant of value is the strategic position of a buyer.

Beauty is in the eye of the beholder. Factors such as economies of scale, complimentary products and markets, market domination or even fast tracking of growth, can see particular buyers pay more or less for acquisitions than an accountant's valuation.

Improving business value

Most people will paint the house, weed the garden and fix the broken gutter before they put their house up for sale.

Business owners ought to undertake similar steps when preparing to sell their business.

So many owners view their businesses as their "superannuation nest egg". It represents a one-off opportunity to convert a lifetime of effort into wealth. Often the majority of the family's wealth is tied up in the business, invariably all at risk and highly dependent on a successful exit outcome. Clearly a strategy must be set to maximise value. The aim is to get the business "investment ready".

For example, what must be done to reduce the perception that the business will no longer prosper without the business owner? Hence, what are the implications for the management structure, policies and procedures, reporting, ongoing innovation and creativity and ultimately, the drive behind the business?

By attending to "future risk" factors such as these, the business becomes more mature and will usually be in a better position to grow and prosper without the business owner's daily influence.

Properly executed, value grows exponentially.

It can take up to five years to become "investment ready" so it is important to start preparing early.

Selling the business

An Information Memorandum is the backbone of a professionally structured exit methodology.

An Information Memorandum is a document which highlights the key value drivers in the business and presents the opportunities and challenges in a positive manner. Importantly, it is structured so prospective purchasers can quickly and easily assess the strategic significance of the opportunity and be able to propose an indicative offer for the business.

This document must be capable of withstanding a due diligence process.

Armed with an Information Memorandum, an investment ready business owner can commence the next phase of selling... identification of a buyer.

Not surprisingly, in around 60% of cases, business owners already know their future buyer. It may be a family member, competitor, a supplier or even a client. A list of known suitors is easily assembled. Attracting the other 40% requires a sales program using mass marketing and multimedia outlets.

Throughout the process, a confidentiality strategy is usually critical.

Business owners might be wise to leave the negotiation, documentation, due diligence and settlement to the professionals. There would be nothing worse than frightening a prospective buyer away at the last minute when their due diligence reveals falling profits attributable to a distracted business owner.

Finally, it is the after-tax outcome which matters most.

The whole selling process is a procedural methodology structured to attract the right buyer who is prepared to pay a good price for a business which clearly demonstrates strategic advantage through acquisition.

Some reasons for not selling

- the business is part of the family
- an important legacy
- best long-term investment available
- opportunity for the children
- do not want the children to inherit a lot of cash
- the business is a flagship
- important for the employees
- something meaningful to do – family pride and heritage
- sense of social responsibility to the community

Transitioning the family business presents the opportunity for continuity. While the family business owner may have the intention to pass the business to family members it is essential to ensure the skill and motivation of the next generation. Addressing this earlier rather than later avoids assumptions and expectations of the incumbent generation.

The dynamics of a family in business presents founders with unique challenges and an overriding responsibility to plan for the future – their own, the firm's and the family's.

Undertaking a planning process for generational transfer involves both practical and emotional considerations and utilising an independent facilitator for this process can help separate the family and business issues. Gaining buy-in from all key stakeholders is essential for a successful transition.

Concluding the sale

Once the money is in the bank, most business owners become risk averse, quite understandably.

For most of their lives, business owners have risked most of their wealth to be in this once-in-a-lifetime position. They know how to run a business, but how can they make the transition from a risk taker to that of custodian?

Sadly, too many business owners get this bit wrong!

What does this "pot of gold" represent? It represents the future security, income and lifestyles for the business owner and their dependents for the term of their lives.

It represents the opportunity to pass wealth to the next generation and beyond.

- how can investments be structured to provide good returns but mindful of the risk profile of the family?
- how can taxation be legally minimised?
- how can the estate planning be properly structured to incorporate superannuation, insurance, wills and trusts?
- how can the owner remain mentally challenged?

A comprehensive wealth management strategy should bring together all of these components. Importantly, like planning for the sale itself, it should not be left to the last minute.

Key contacts

Grant Thornton design exit strategies for business owners to meet their lifestyle, income, wealth and security objectives. Whether the exit horizon is near or far, the best exit outcomes require careful planning and preparation. We are here to help.

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